## Missouri Division of Finance

# UPDATE

## A Report of Missouri State Chartered Financial Institutions

Issue 02-2 December 2002

**From . . .**
**Acting Commissioner**
**D. Eric McClure**

Missouri state chartered banks proved themselves equal to the many challenges of 2002: a soft economy, a record number of bankruptcies, historically low interest rates, and the loss of many manufacturing jobs statewide. The overall safety and soundness of our banks is good. Capital levels are very high while loss reserves and earnings continue to be at satisfactory levels. The number of problem banks actually declined during the year which is very gratifying: we had earlier projected an increase. Net interest margins are good despite the record low interest rates. These low rates have kept our housing market strong but have also made routine investment decisions very challenging. Understanding the additional interest rate risk on a bond yielding just 25 more basis points is often very difficult. I take pride in noting that it has now been ten years since a Missouri state chartered bank failed and look toward the future with confidence.

An ongoing challenge for our industry is to manage earnings effectively during times of volatile interest rates. Of course, no one can accurately predict interest rate changes, but a 200-300 basis point rate shock, utilized in many planning models, has a much more dramatic impact when rates are at these historic lows. While rates may continue to decline, it is important to be positioned for the possibility of rising interest rates which will affect many things including the housing market and debt service coverage ratios. Mortgage prepayment speeds will become slower, and fewer bonds will be called which will effectively extend their anticipated maturities.

Our banks are well managed and I am confident we will meet the many challenges that we will face in 2003.

We are planning our Outreach meetings around the state for late February and early March. The format will be similar to what we did in the fall of 2001. The preliminary dates and locations are listed elsewhere in this Update and I hope to see you in attendance.

Happy Holidays!

**GENERAL USURY**

Section 408.030 provides that the Director of Finance shall declare the quarterly market rate of interest each quarter, post it in accor-dance with Section 361.110 and publish it in appropriate publications. Said quarterly market rate for the period October 1, 2002 through December 31, 2002 shall be 8.1%; as an alternative, 10% may be used.

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- Changing Hours or Closing
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## CHANGING HOURS OR CLOSING

***Business Hours:***
This time of year many institutions modify business hours to better serve customers or accommodate employees. A change in banking hours does not require notice or approval by bank regulators; however, we always encourage that customers be afforded several weeks' notice of the change to avoid confusion.

***Closings:***
Banks usually close on public holidays such as Christmas and New Years Day. Some institutions will opt to close on days around holidays. Per Section 362.520 RSMo, the board will need to pass a resolution authorizing the closing at least 15 days in advance, with customer notice posted in the institution for the same time period. No approval by or notice to regulators is required in this circumstance. Inclement weather may also force closure of the main bank or branches unexpectedly. The statute also addresses emergency closings. In this event, a bank official should notify the Division of Finance by letter, fax, telephone or email within 12 hours of closing any location. If unable to reopen within 24 hours, officials must contact the Division for permission to remain closed for a longer period. A full report of any emergency closing must be subsequently provided to the Division.

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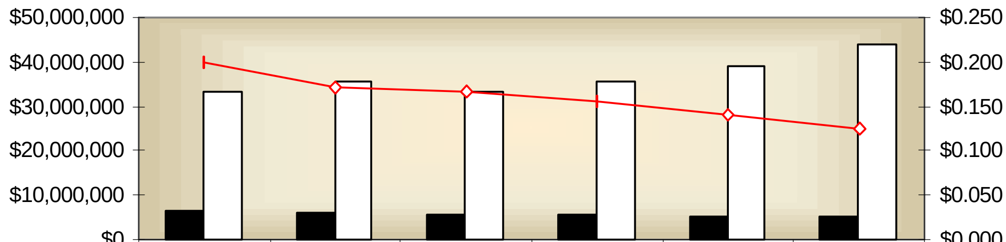
### OUTREACH MEETINGS

A little more than one year ago, we held Outreach meetings around the state and from the strong attendance it appears these meetings were productive and well received by all who attended. Plans are being made to hold these meetings again in February and March 2003 at various locations across the state. This type of forum provides an easy and accessible way to discuss current issues and concerns that affect the banking industry, and gives you the chance to meet the key members of our staff. Please check your calendars. Enrollment materials will be mailed out later and will contain the specific location for the meeting in your area. We hope you will be able to attend.

| | |
|---|---|
| February 26, 2003 | St. Louis area |
| February 27, 2003 | Sikeston area |
| March 4, 2003 | Columbia area (Please note this is a change from a tentative date previously published.) |
| March 6, 2003 | Springfield area |
| March 11, 2003 | Kansas City area |

## ASSESSMENTS

We strive very hard to provide Missouri state-chartered financial institutions with high quality service at a reasonable cost, and we are pleased to report that the assessment rate paid by each institution, to provide our funding, has declined for six consecutive fiscal years since 1998. This cost reduction is a combined result of consolidation in the banking industry and greater efficiencies achieved by the Division of Finance. The chart below shows the last six fiscal years, the net assessment, total assets of Missouri state-chartered banks, and the average assessment rate per $1,000 in assets. Although total assets under our supervision have increased $10,714,000,000 (32 percent) since 1998, we are proud of the fact that at the same time, we have been able to reduce the cost of state regulation to our banks.




| | FY98 | FY99 | FY00 | FY01 | FY02 | FY03 |
|---|---|---|---|---|---|---|
| Net Assessment ($) | $6,607,287 | $6,055,319 | $5,585,972 | $5,513,040 | $5,474,343 | $5,421,057 |
| Total Assets of Banks and Trust Companies ($ 000) | $33,196,532 | $35,491,641 | $33,352,535 | $35,563,441 | $39,129,835 | $43,911,312 |
| Average Assessment Rate ($ per $ 000 in assets) | $0.199 | $0.171 | $0.167 | $0.155 | $0.140 | $0.125 |

## BUSINESS CUT-OFF

Banks often ask whether they can establish an alternate business cut-off time at a branch, in order to allow sufficient time to transport deposit items to the main office and meet the processing deadline for that day.

Regulation CC, as well as Missouri's Uniform Commercial Code, provides that a bank may establish a business cut-off time of no earlier than 2:00 p.m. for receipt of deposits. This applies to the main office as well as to branches, but not ATMs, which are allowed a business cut-off time of no earlier than 12:00 noon.

The only way an alternate business cut-off time may be established is by closing the lobby prior to 2:00 p.m. This officially ends the business day but permits limited services to continue through the drive-up or walk-up teller window. Should the lobby be re-opened again later in the day, it would have to occur after 2:00 p.m., otherwise, the deposits received would have to be posted on the current day's business.

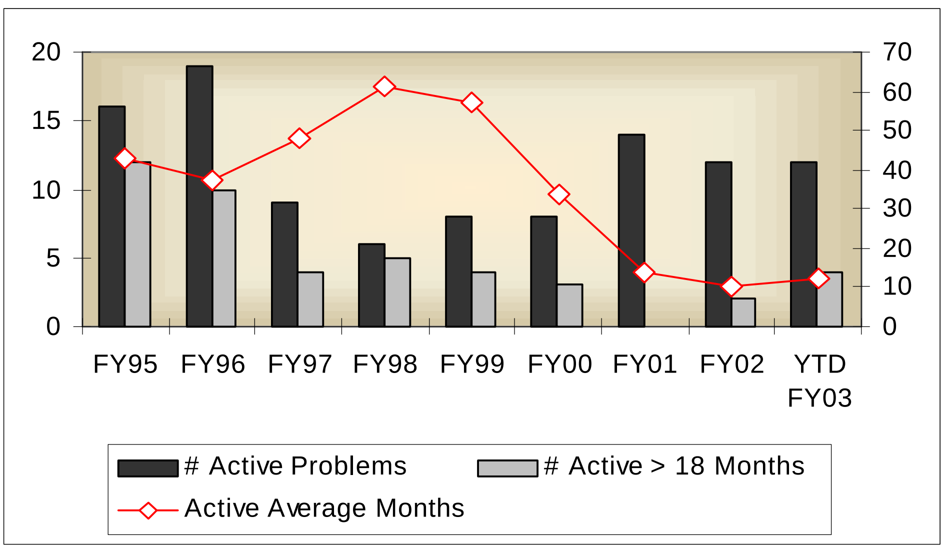
It is important that the bank's internal policies correctly reflect the business cut-off time and that customers be provided this information upon request.

## PROBLEM BANKS

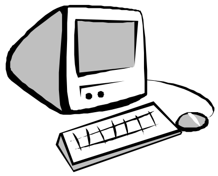
Several years ago, the Division of Finance established a strategic goal of limiting the number of problem banks (those with composite CAMELS ratings of 3 or worse) to 15. With the deteriorating national and state economies, we had anticipated exceeding this goal in 2002. Fortunately, as the result of proactive measures by examiners and bank managers, the number of problem banks has been held below our strategic limit and as of September 30, 2002, the total stood at 12.

While we strive to limit the number of problem banks, another objective is to rehabilitate those that do slip into problem status within 18 months. This goal is quite aggressive as the banks will have just one or two exams within this time frame to improve to the degree necessary to be removed from problem status. We have been successful more times than not in accomplishing this goal over the last seven years, as 58 percent of problem banks (60 in number) since 1995, have been restored to satisfactory condition within the aforementioned 18 months.

The chart below depicts the trend in the number of problem banks and the history of rehabilitation successes. Of the 12 problem banks existing on September 30, 2002, the average length of time in problem status was 12.3 months.



## Wire Transfer Risk



Each examination includes an assessment of the bank's electronic funds transfer (wire transfer) risk. Most banks access large dollar wholesale transfer of funds through the FEDWIRE payments system or a correspondent bank network. Functions of wire transfer operation include daily funds transfers and securities transactions. Bank managers and regulators are concerned about the quality of internal controls in order to prevent fraud and identify inherent risks associated with funds transfer activities. We recently polled our field examiners for the most common exceptions they see in community banks. The following are frequent problem areas:

- *Written Policies* – Often there is no written policy regarding wire transfers, or the policy is seriously outdated. Corporate policies are needed to address authorized personnel, physical security, data security, operations, credit risk, and disaster recovery.

- *Segregation of Duties, Dual Control* – In many banks a single employee has unlimited control over a transfer transaction. Allowing one employee the ability to originate a transfer, and also serve as system administrator or to verify, approve or reconcile transactions is an invitation for internal fraud.

- *Physical and Data Security* – Frequently, data entry terminals are not physically restricted from unauthorized personnel and user manuals and access codes are left in open areas. It is not uncommon to find appropriate software locks are not in place and system security settings are incorrect. Passwords should be severely restricted and changed often. Automatic time-out and time-of-day controls should also restrict access during and after business hours.

- *Audit Review* - Primary exceptions in this area are lack of coverage in the scope of internal and external audits, and absence of daily reconcilement of funds transfer activity.

It's much cheaper to be proactive instead of reactive when it comes to fraud. You are encouraged to assess the effectiveness of wire transfer policies and controls in your institution.

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### SUMMARY OF 2002 BANKING LEGISLATION AND CHANGES IN REGULATIONS

For a recap of these items, please refer to the June 2002 UPDATE, available on our website at www.missouri-finance.org.

## SURVEY OF REVENUE PRODUCING SERVICES

The Division of Finance surveyed state-chartered banks and trust companies in July 2002 to obtain a picture of the number of institutions that participate in the many nontraditional revenue producing activities that banks enjoy. The results are derived from 301 institutions, a response rate of 99 percent. We appreciate the time and effort of bank personnel who participated in the survey. The following is a comparison of year 2000 and 2002 results:

| ACTIVITY | AFFIRMATIVE RESPONSE | |
|---|---|---|
| | 2000 | 2002 |
| ***TRUST SERVICES*** | | |
| ♦ Ability to offer full trust services | 33% | 23% |
| ♦ Serve as Originating Trustee | 7% | 5% |
| ***INSURANCE SALES*** | | |
| ♦ Insurance products are available at the institution | 26% | 32% |
| ♦ Of those that offer such products, sales are effected by: | | |
| The bank itself | 40%* | 29%* |
| Affiliate or holding co. | 20%* | 22%* |
| Bank subsidiary | 21%* | 16%* |
| Third party contractor | 46%* | 43%* |
| ***NONDEPOSIT INVESTMENT PRODUCTS*** | | |
| ♦ Securities, annuities or mutual funds products are available at the institution | 32% | 39% |
| ♦ Of those that offer such products, sales are effected by: | | |
| The bank itself | 44%* | 25%* |
| Affiliate or holding co. | 17%* | 16%* |
| Bank subsidiary | 12%* | 13%* |
| Third party contractor | 75%* | 57%* |
| ***INTERNET ACTIVITY*** | | |
| ♦ Internet services available | 41% | 52% |
| ♦ Of those that offer such products, the level of website activity is: | | |
| Informational only | 54% | 29% |
| Communication/View accounts | 5% | 4% |
| Transactional | 41% | 67% |
| ***OTHER ACTIVITY*** | | |
| ♦ Real Estate Development Corporation, Community Development Corporation, Collection Agency, Credit Bureau, Tax Service, Residential Mortgage Loan Company, Cash Management Services | 8% | 25% |
| ***NEW ACTIVITIES FROM FINANCIAL MODERNIZATION (GRAMM-LEACH-BLILEY)*** | | |
| ♦ Holding company plans to become a "Financial Holding Company" | 16% | 9% |
| ♦ Bank plans to establish a "Financial Subsidiary" | 6% | 4% |

** Several banks indicated sales are effected by multiple providers.*

## BANKING PERFORMANCE - 2002

Missouri state-chartered banks remain in sound overall condition. As of September 30, 2002, 303 state-chartered banks held $45.0 billion in assets and $36.8 billion in deposits. This represents asset growth of 10.1 percent and deposit growth of 9.2 percent since September 30, 2001 when 306 banks held assets and deposits of $40.9 billion and $33.7 billion, respectively. During the preceding twelve months, five banks left the state banking system though merger or consolidation. Two new banks were chartered. The remaining 303 banks enjoyed asset growth of 11.3 percent.

The net interest margin and return on assets have both improved for the third quarter of 2002 compared to 2001 results. The return on assets improvement is significant with net income of Missouri state-chartered banks increasing by $56 million, or 16.6 percent. All but 5 banks (98 percent) were profitable as of September 30, 2002.

Selected performance measurements of Missouri state-chartered banks include:

| | **Missouri State Banks** | | | |
|---|---|---|---|---|
| | 9/30/2002 | 9/30/2001 | 12/31/2001 | 12/31/2000 |
| Interest Income/Earning Assets | 6.30 | 7.73 | 7.22 | 7.87 |
| Interest Expense/Earning Assets | 2.41 | 3.91 | 3.54 | 3.98 |
| Net Interest Income/Earning Assets | 3.89 | 3.82 | 3.68 | 3.89 |
| Loan Loss Provision/Average Assets | 0.25 | 0.25 | 0.29 | 0.23 |
| Net Income/Average Assets | 1.18 | 1.11 | 1.05 | 1.12 |
| | | | | |
| Net Charge-offs/Loans | 0.17 | 0.20 | 0.32 | 0.19 |
| Non Performing Loans/Total Loans | 2.15 | 2.23 | 2.42 | 2.25 |
| | | | | |
| Tangible Equity Capital/Assets | 9.05 | 9.04 | 8.69 | 8.74 |
| Loans to Assets | 69.52 | 69.43 | 68.64 | 69.41 |
| Earning Assets/Assets | 92.80 | 93.10 | 92.66 | 93.20 |

# REMINDER LIST

## *ANNUAL ACTIONS FOR STATE LAW*

Division of Finance State of Missouri

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***362.044 RSMo Annual Stockholders' Meetings***

- Hold within the State of Missouri as prescribed in bank's bylaws. If absent such provision, must be held at the main banking house.
- Annual meeting conducted on date fixed in bylaws, or, if not so fixed, then on the second Monday of January (January 13, 2003).
- Refer to statute for notice/waiver requirements.

***362.270 RSMo Organizational Meeting of Directors***

- Hold within 30 days of the annual stockholders' meeting.
- Elect a director as chief executive officer. The CEO may be designated as president or other appropriate title.
- Elect one or more vice presidents.
- Elect other officers as required by the bylaws.

***362.245 RSMo Board of Directors Qualifications***

- Majority of directors must reside in Missouri or within 100 miles of the main banking house.
- All non-Missouri residents must file consent to service form with bank president, regardless of whether they live within 100 miles of main banking house.

***362.250 RSMo Oath of Directors***

- Every director must qualify within 30 days of election by filing an oath of office with the bank.
- Completed oaths must be immediately transmitted to the Commissioner of Finance.

***362.340 RSMo Employees to Give Bond***

- Board shall require sufficient fidelity bonds on all active officers and employees.
- Bond must be approved by board and noted in the board minutes at least annually.
- Bonding amounts shall be reported to the Commissioner of Finance and are subject to approval.

# QUICK REFERENCE OF STATE LAWS AND REGULATIONS

This reference is designed as a summary of laws and regulations frequently reviewed during the examination process. The listing is not all inclusive of state banking statutes applicable to state-chartered banks and trust companies. Reference should be made to the actual statute or regulation for a thorough understanding of the subject.

## RSMo 110.010 and 110.020 Deposits of Public Funds

Requires deposits of public entities to be fully secured (net of FDIC insurance) by acceptable securities or a surety bond as described in RSMo 30.270

## RSMo 362.073 Change in Control

President notifies the DOF, within one business day, anytime there is a 25% change in stock ownership or there is a change in voting control.

## RSMo 362.105 and 362.106 Powers and Authority of Banks and Trust Companies

Details permissible activities for financial institutions and includes requirements for:
1) Prior approval of DOF for purchase or lease of real estate.
2) Examination agreement for other entities to process or store data.
3) REDC, CDC, financial subsidiary, super wildcard authority.

## RSMo 362.119 Investment in Trust Companies

May invest up to 5% of capital in a trust company or trust holding company if majority of stock ownership is restricted to banks.

## RSMo 362.165 Restrictions on Taking and Holding Real Estate

Real estate for debts previously contracted must be conveyed to bank directly and may be held for a maximum of ten years.

## RSMo 362.170 Legal Lending Limit/Loans to Salaried Officers

Unimpaired capital is defined as capital notes, total equity capital, plus reserves not subject to known charges based on most recent Call Report. (SFAS 115 capital adjustment is also reversed. Goodwill, other intangibles are counted.)

**Legal Lending Limit**

Loans to any individual, partnership, or entity cannot exceed these percentages of unimpaired capital:

- 15% - bank located in city of 100,000 or more, unless CAMELS 1 or 2 then limit is 25%.
- 20% - bank located in city of 7,001 - 99,999, unless CAMELS 1 or 2 then limit is 25%.
- 25% - bank located in city 7,000 or less.
- 35% - If amount over the legal lending limit is collateralized by warehouse receipts for insured agricultural products stored in public storage facilities. Value of the collateral must exceed the loan amount by 15%.

*Exceptions to legal loan limit:*

(1) Bonds or debt of U.S. government or any political subdivision in Missouri;
(2) Bonds or debt guaranteed by the U.S. government;
(3) General obligation bonds or debt of any other state, county, city, or school district with over 50M inhabitants which have not defaulted for more than 120 days on any general obligation debt in the last 10 years;
(4) Loans insured or guaranteed by any agency of the U.S. government or the state of MO;
(5) Notes secured by direct U.S. government obligations;
(6) Loans secured by segregated deposit accounts in lending bank;
(7) Direct obligations, loans guaranteed or collateralized by obligations of FFCB, FHLB, FHLMC, FNMA, GNMA, or SLMA.
(8) FHLB stock and selected well-rated CMOs, may invest 2x loan limit.

Guarantees are not included if guarantor does not receive the proceeds. Corporate or LLC debt is not normally attributed to stockholders/members.

**362.170.2(5) – Loans to Salaried Officers:**

Aggregate loans to a salaried officer are limited to 10% of unimpaired capital to any individual and 25% to all salaried officers combined. Loans must have prior written approval by the board or executive committee, the borrowing officer not voting, and must be on the proper form. Loans to corporations are attributed to salaried officer if officer controls a majority of corporate stock.

**4 CSR 140-2.080 – Legal Loan Limit**

Guidelines for aggregating debts of two or more borrowers considering: use of proceeds, structure of the enterprise, source of repayment, management control, and borrowers' interdependence.

**4 CSR 140-2.081 – Legal Loan Limit – Limited Partnerships**

Loans to partnerships are attributed in full to each general partner. In limited partnerships, full amount of the debt is attributed to the general partner, but not limited partners.

**4 CSR 140-6.055 – Bank Investment in Mutual Funds**

Investment in each mutual fund limited to legal loan limit and the fund portfolio must consist of assets the bank could purchase directly.

## RSMo 362.245 Qualifications of Board of Directors

Details requirements for boards of directors. The affairs of each financial institution will be managed by a board of 5 – 35 directors, who are elected annually. Each director must be a U.S. citizen. The majority of each board must reside in Missouri or within a 100 mile radius of the main banking house. Directors residing outside Missouri must complete a consent to service form. No one can serve as a director if bank holds a judgment against them.

## RSMo 362.247 Majority of the Board of Directors Constitutes a Quorum

Acts of a majority of the board of directors at a meeting at which a quorum is present shall be acts of the board unless a greater number is required by law, the articles of agreement or bylaws. Telephonic and video conferencing permissible for "1 and 2" rated banks, subject to statutory procedures. Board may take action by unanimous written consent

## RSMo 362.250 Oath of Directors

Shall be administered within 30 days of election and must be transmitted immediately to the DOF.

## RSMo 362.260 Vacancies in Board of Directors

Board vacancies shall be filled by the stockholders but vacancies not exceeding one-third of the whole number may be filled by the board by majority vote, until next shareholders' meeting.

## RSMo 362.265 Change in the Number of Directors

The stockholders at any annual or special meeting can change the number of directors by a majority vote as long as the number remains between 5 and 35. The board of directors by a two-thirds majority vote can add up to two additional temporary directors between shareholder meetings. A copy of the resolution changing the number of directors shall be immediately filed with the DOF.

## RSMo 362.270 Organizational Meeting of the Board

An organizational meeting of the directors shall be held within 30 days after the annual stockholders' meeting at which directors are elected. At the organizational meeting, a chief executive officer (can be designated by any title) shall be elected from the board and one or more vice presidents and other officers shall be elected as provided for in the bylaws.

### RSMo 362.275 Lists to be Reviewed at Monthly Board Meetings

Board of directors must review the following lists at each monthly meeting:

(1) Aggregate loans created, extended, or renewed since the last list cut off date exceeding 5% of the legal loan limit but in no case less than $10M;
(2) Aggregate indebtedness to borrowers whose debt exceeds 5 times the minimum amount but in no case less than $50M;
(3) Loans past due 30 days or more;
(4) Indebtedness of all officers, directors, and employees. Guarantees and unfunded commitments are included in list (4).

Collateral, if any, shall be described on each list (1-4).

Board or executive committee of the board may approve actions by unanimous consent without a formal meeting.

## RSMo 362.290 Communication from the Commissioner of Finance

Communication from the DOF concerning an examination or containing suggestions as to the conduct of the bank shall be submitted to the board at the next meeting and noted in the minutes.

## RSMo 362.295 Reports to the Commissioner of Finance

Reports (Call Reports) shall be submitted to the DOF, published in a local publication, and displayed in the main banking house in a location accessible to all. The publishing requirement will be waived if a notice is posted in the lobby that a copy of the report will be provided free of charge to all who request it.

## RSMo 362.340 Employees to Give Bond

Directors approve insurance and bond program annually. Subject to the approval of the DOF.

## RSMo 447.505 and 447.539 Abandoned Property

Property is presumed abandoned if within the last five years no activity has occurred in deposit accounts and the bank has not had any contact with customer (including the customer accepting mail). Abandoned property as of the prior June 30th must be reported to the State Treasurer by each November 1st.

## 4 CSR 140-2.055 Purchase of Key-Man Insurance

Cannot purchase insurance as an investment. May purchase life insurance products on bank insiders to cover loss of key person, provide employee benefit, or fund compensation benefits. Bank must be owner and beneficiary of policy. Aggregate CSV per company restricted to legal loan limit.

## 4 CSR 140-2.060 Investment in Fixed Assets

DOF approval is required for purchase or lease of real property. Fixed assets, including real property, equipment and furniture, limited to less than 50% of unimpaired capital. Limit increased to 75% for well-capitalized 1 or 2 rated banks per 362.106 authority. Exception in 362.105 allows investment up to legal loan limit for banks with total assets of $200 million or more.

## 4 CSR 140-2.070 Accounting for ORE

ORE shall be recorded at the lesser of fair market value or book value plus allowable expenses. Allowable expenses include: accrued interest, foreclosure costs (including legal fees), and expenses related to the improvement of the property's condition. Legal expenses incurred after foreclosure and expenses that maintain the value of the property should be expensed as incurred. Allowable expenses can be capitalized up to six months after transfer as long as the total book value does not exceed fair market value.

ORE book value exceeds $250M - independent qualified appraisal is required. Book value $250M or less - qualified evaluation of value is required. Compliance is achieved if an appraisal was obtained six months prior to acquisition or an engagement letter is obtained within 30 days after foreclosure; however, the appraisal must be in file within 90 days.

## 4 CSR 140-2.110 Management and Other Fees Paid to Insiders

Fees paid to insiders must reflect fair market value and be properly documented and retained in permanent records.

## 4 CSR 140-2.138 Financial Subsidiaries

May establish subsidiary for activities bank can perform directly, and those authorized by 362.105 and Gramm-Leach-Bliley Financial Modernization Act of 1999. Must meet minimum guidelines and DOF notice requirements.